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Supreme Court, U.S.
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No. _____

In The

# Supreme Court of the United States

STATE OF MINNESOTA, DEPARTMENT OF REVENUE,

*Petitioner,*

v.

UNITED STATES OF AMERICA,

*Respondent.*

**On Petition For Writ Of Certiorari To The United States Court Of Appeals For The Eighth Circuit**

## PETITION FOR A WRIT OF CERTIORARI

MIKE HATCH
Attorney General,
State of Minnesota

BARRY R. GRELLER
Assistant Attorney General
*(Counsel of Record)*

STEPHEN F. SIMON
Assistant Attorney General
*(Of Counsel)*

600 North Robert Street,
Suite 4000
St. Paul, MN 55146-0600
Telephone: (651) 296-0982

*Attorneys for Petitioner*

COCKLE LAW BRIEF PRINTING CO., (800) 225-6964
OR CALL COLLECT (402) 342-2831

468

## QUESTION PRESENTED

This Court's test for determining whether tax liens are "choate" for lien priority purposes examines the point at which the liens become summarily enforceable by the taxing authority. Minnesota's tax liens became summarily enforceable under Minnesota law as of the date on which a taxpayer filed its returns. Were Minnesota's tax liens "choate" as of the date on which the taxpayer filed its tax returns, so that its liens were superior to the IRS liens?

TABLE OF CONTENTS

Page

QUESTION PRESENTED ..... i

TABLE OF AUTHORITIES ..... iii

OPINIONS BELOW ..... 1

JURISDICTION ..... 1

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED ..... 1

STATEMENT OF THE CASE ..... 2

REASONS FOR GRANTING THE PETITION ..... 4

I. The Eighth Circuit Decision Runs Afoul Of This Court's Lien Priority Jurisprudence ..... 4

II. The Eighth Circuit Decision Attributes Statutory Absurdities To The Minnesota Legislature ..... 9

A. The Court Of Appeals' Reading Of Minn. Stat. § 289A.35 Ignores Core Choateness Principles, Renders Other Minnesota Tax Statutes Superfluous, And Fails To Address The Facts Of This Case ..... 10

B. The Court Of Appeals Mischaracterizes The Language Of Minnesota's Late Payment Penalty Statute, And Ignores The Other Penalty Statutes At Issue In This Case ..... 14

CONCLUSION ..... 16

# TABLE OF AUTHORITIES

Page

## Federal Cases

*Aquilano v. United States*, 363 U.S. 509 (1960) ..... 4

*Comm'r of Internal Revenue v. Brown*, 380 U.S. 563 (1965) ..... 10

*Dep't of Revenue of Oregon v. ACF Industries*, 510 U.S. 332 (1994) ..... 10

*Escoe v. Zerbst*, 295 U.S. 490 (1935) ..... 11

*Middlesex Savings Bank v. Johnson*, 777 F. Supp. 1024 (D. Mass. 1991) ..... 8

*Minnesota, Dep't of Revenue v. United States*, 184 F.3d 725 (8th Cir. 1999) ..... 1

*In re Priest*, 712 F.2d 1326 (9th Cir. 1983), *modified*, 725 F.2d 477 (9th Cir. 1984) ..... 7

*Tully v. Griffin*, 429 U.S. 68 (1976) ..... 10

*United States v. New Britain*, 347 U.S. 81 (1954) .. 5, 6, 7

*United States v. Vermont*, 377 U.S. 351 (1964) .....5, 7

*United States v. Zacks*, 375 U.S. 59 (1963) ..... 10

## State Cases

*Carl Bolander & Sons Co. v. Minneapolis*, 488 N.W.2d 804 (Minn. Ct. App. 1992), *aff'd*, 502 N.W.2d 203 (Minn. 1993) ..... 11

*Heller v. Wolner*, 269 N.W.2d 31 (Minn. 1978) ..... 11

*State v. Lucas*, 589 N.W.2d 91 (Minn. 1999) ..... 10

*State v. McKown*, 475 N.W.2d 63 (Minn.), *cert. denied*, 502 U.S. 1036 (1991) ..... 10

TABLE OF AUTHORITIES – Continued

Page

FEDERAL CONSTITUTION, STATUTES AND REGULATIONS

26 U.S.C. § 2706(1) ..... 8

26 U.S.C. § 7426 ..... 3

28 U.S.C. § 1254(1) (1998) ..... 1

28 U.S.C. § 1346(e) ..... 2

28 U.S.C. § 6532(c) ..... 2

28 U.S.C. § 7426 ..... 2

STATE CONSTITUTION, STATUTES AND RULES

Minn. Stat. § 270.65 (1992) ..... 1, 6, 12, 13

Minn. Stat. § 270.69, subd. 1 (1992) ..... 1, 6, 12

Minn. Stat. § 270.69, subd. 4 (1992) ..... 1, 6, 12

Minn. Stat. § 270.69, subd. 6 (1992) ..... 1, 6, 12

Minn. Stat. § 289A.35 (1992) ..... 1, 11

Minn. Stat. § 289A.37, subd. 1(a) (1992) ..... 1, 13

Minn. Stat. § 289A.55, subd. 9(a) (1992) ..... 1, 15

Minn. Stat. § 289A.60, subd. 1 (1992) ..... 1, 14

Minn. Stat. § 289A.60, subd. 2 (1991 Supp.) ..... 1, 15

Minn. Stat. § 289A.63 (1992) ..... 8

Minn. Stat. § 645.17, subd. 1 (1998) ..... 1, 11

## PETITION FOR A WRIT OF CERTIORARI

Petitioner respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Eighth Circuit in this case.

## OPINIONS BELOW

The opinion of the court of appeals (App. 1-15, *infra*) is reported at 184 F.3d 725. The opinion of the district court (App. 16-21, *infra*) is not reported.

## JURISDICTION

The court of appeals entered its judgment on July 7, 1999 (App. 23, *infra*). The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1) (1998).

## CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

Minn. Stat. § 270.65 (1992); Minn. Stat. § 270.69, subd. 1 (1992); Minn. Stat. § 270.69, subd. 4 (1992); Minn. Stat. § 270.69, subd. 6 (1992); Minn. Stat. § 289A.35 (1992); Minn. Stat. § 289A.37, subd. 1(a) (1992); Minn. Stat. § 289A.55, subd. 9(a) (1992); Minn. Stat. § 289A.60, subd. 1 (1992); Minn. Stat. § 289A.60, subd. 2 (1992); Minn. Stat. § 645.17, subd. 1 (1998).

## STATEMENT OF THE CASE

Petitioner State of Minnesota ("the State"), Department of Revenue ("the Department"), brought this action for wrongful levy against Respondent United States in the United States District Court for the District of Minnesota. The jurisdiction of the district court was invoked under 28 U.S.C. § 1346(e), 28 U.S.C. § 6532(c), and 28 U.S.C. § 7426.

The issue in the district court was whether the State's tax liens were prior and superior to the liens of the Internal Revenue Service ("IRS"). The relevant facts were stipulated. The facts giving rise to the dispute began on June 2, 1992, when a Minnesota-based taxpayer, Prime Factors Communications, Inc. ("Prime Factors") filed late state and federal withholding tax returns for several quarterly tax periods. Among those periods were March 1991 through March 1992, the contested periods at issue in this case. Prime Factors did not remit payment with those returns to either the State or the IRS. On August 20, 1992, the Department processed the tax returns by making an initial entry into its computer system. On March 3, 1993, the Department filed a state tax lien in the home county of Prime Factors reflecting a total outstanding state tax liability of $35,623.73. The IRS made its assessments for the contested periods on August 3, 1992 and August 10, 1992. It then filed a federal tax lien in the home county of Prime Factors on January 14, 1993, reflecting the total outstanding federal tax amount of $248,658.33.

On or about June 21, 1996, Charles and Lorilee Leininger purchased certain property belonging to Prime

Factors. Prior to the sale, on June 10, 1996, the IRS served a Notice of Levy on the closing agent to the sale to assure that the federal liens would be satisfied out of the sale proceeds. At the time of the purchase the property in question was subject to the unsatisfied state and federal tax liens. After deducting settlement charges and delinquent property taxes, $34,688.96 remained from the sale to pay state and federal taxing authorities. Of that amount, the Minnesota Department of Economic Security received $16,386.40, the IRS received $14,579.22, and the Department received $3,723.34 in satisfaction of a portion of its lien for uncontested tax periods not at issue in this case.

The State filed a wrongful levy action against the United States, pursuant to 26 U.S.C. § 7426, on March 3, 1997. The State alleged that the IRS wrongfully levied upon $14,378 of the sales proceeds from the Prime Factors property. More specifically, the State contended that its tax liens for the contested periods were prior to and superior to the IRS tax liens. Both parties stipulated to all material facts, and filed cross-motions for summary judgment.

Following argument on the motions, the district court granted summary judgment to the State. The court held that the State's liens were choate and summarily enforceable under applicable state law as of the date on which Prime Factors filed its tax returns, June 2, 1992, and that the IRS liens were not choate and enforceable until the IRS made a formal assessment against Prime Factors some two months later.

The United States Court of Appeals for the Eighth Circuit reversed. In its opinion, the court held that the receipt of a tax return by the State is insufficient to meet the federal standard for choateness. Specifically, the court held that the determination of a taxpayer's liability under Minnesota law mandates some sort of action by the State subsequent to the filing of a tax return. Accordingly, the court ruled that the federal tax liens at issue were prior to and superior to the State's tax liens.

## REASONS FOR GRANTING THE PETITION

The Eighth Circuit decision in this case contravenes this Court's precedents in two distinct ways. First, the decision disregards paramount principles regarding priority among competing liens. Second, the decision disregards this Court's time-honored statutory construction principles by attributing absurd intentions to the Minnesota Legislature. Ultimately, the Court should accept review of this case in order to correct a serious error of law.

### I. The Eighth Circuit Decision Runs Afoul Of This Court's Lien Priority Jurisprudence.

This Court's rules regarding lien priority are long-standing and straightforward. The determination of what property rights exist is a question of state law. *Aquilano v. United States*, 363 U.S. 509, 512-13 (1960). However, federal law determines the question of priority among competing liens. *Id.* at 513-14. The enduring principle under federal law, with regard to lien priority disputes, is that

"a prior lien gives a prior claim, which is entitled to prior satisfaction out of the subject it binds. . . . " *United States v. New Britain*, 347 U.S. 81, 85 (1954) (quoting *Rankin & Schatzell v. Scott*, (12 Wheat.) 25 U.S. 177, 179 (1827)). In its more familiar form, the cardinal rule is that "the first in time is the first in right." *Id.* at 85.

A determination of which lien is first in time depends upon the doctrine of "choateness." A lien is choate for priority purposes when it is "perfected" in the sense that "the identity of the lienor, the property subject to the lien, and the amount of the lien are established." *New Britain*, 347 U.S. at 84. The same standard for choateness applies to both state and federal tax liens. *United States v. Vermont*, 377 U.S. 351, 358 (1964).

The primary rationale behind the choateness requirement is to ensure that a lien is not subject to "contingencies" which might render it unenforceable. *Id.* at 355 (citing *United States v. Security Trust & Savings Bank*, 340 U.S. 47, 50 (1950)); *New Britain*, 347 U.S. at 86-87. Such "contingencies" may arise when, for example, a particular lien gives a creditor no right to actually proceed against the attached property before obtaining a judgment. *Id.* (citing *United States v. Security Trust & Savings Bank*, 340 U.S. 47, 50 (1950)). The "contingencies" rationale is particularly well-founded in light of the facts in the *Vermont* case. In *Vermont*, the applicable state statute created a lien at the time of assessment. *Vermont*, 377 U.S. at 352. The assessment date was the date on which the state made a formal demand for the amount owed. *Id.* This Court held that the state statute was sufficient to create a choate lien in favor of the state because the lien was *summarily enforceable*. *Id.* at 351. Specifically, the

Court noted that "it is as true of Vermont's lien here as it was of the federal lien in *New Britain* that 'The assessment is given the force of a judgment, and if the amount assessed is not paid when due, administrative officials may seize the debtor's property to satisfy the debt.' " *Id.* (citing *Bull v. United States*, 295 U.S. 247, 260 (1935)). In other words, there were no contingencies which might hinder the state's right or power to enforce its lien. Significantly, the Vermont statute provided for such enforcement only by foreclosure. *Id.* at 359 n.11.

Minnesota law provides for a self-assessing tax lien mechanism. It is undisputed that under Minnesota law a tax lien arises from the date of "assessment."[1] The applicable "assessment date" is the date a return is filed or should have been filed.[2] The lien, being enforceable from the time it arises, is therefore enforceable as of the date on which a taxpayer files a return.[3] Moreover, under Minnesota law tax liens are enforceable at the time tax returns are filed not only by judgment lien foreclosure, but also by levy.[4]

In the instant case, the court of appeals held that the State liens were not choate before the IRS liens. The court concluded that the filing of a tax return is too "imprecise" to serve as an assessment date, and that the State's liens could only become choate when the State determined the amount of the liens with absolute certainty, through some

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[1] Minn. Stat. § 270.69, subd. 1 (1992) (App. 24).

[2] Minn. Stat. § 270.65 (1992) (App. 24).

[3] Minn. Stat. § 270.69, subd. 4 (1992) (App. 24-25).

[4] Minn. Stat. § 270.69, subd. 6 (1992) (App. 25).

sort of additional administrative action, at some later time. As support for its reasoning, the court relied in large part upon *In re Priest*, 712 F.2d 1326 (9th Cir. 1983), *modified*, 725 F.2d 477 (1984), in which the Ninth Circuit Court of Appeals held that a California state tax return was insufficient to satisfy the "amount" prong of the *New Britain* test for choateness, and that some sort of additional administrative action by the state was necessary in order to fix the taxpayer's liability. App. 11-12.

The court of appeals erred fundamentally by overlooking the primacy of this Court's rationale for the choateness doctrine. As this Court's *Vermont* decision explains, choateness depends upon summary enforceability: an absence of "contingencies" which might render a particular lien unenforceable by a particular creditor. Minnesota tax liens meet the summary enforceability test. The applicable Minnesota statutes provide for a self-assessing mechanism. Put another way, the State's liens in both cases were "not contingent on future events" because they were "summarily enforceable" as of the moment the tax returns were filed. Moreover, because Minnesota tax liens are enforceable both by levy and by judgment lien foreclosure, the State has *two* tools with which to enforce its lien, instead of only one. In other words, the Minnesota tax liens in the instant case are even more readily "summarily enforceable" than the tax lien that this Court validated in *Vermont*, which means that any concerns about potential "contingencies" are even less warranted.

There are two additional flaws with the conclusion by the court of appeals that the filing by a taxpayer of a self-assessing tax return cannot serve as the measuring

point for choateness. First, it ignores the practical reality that the precise amount of a tax lien constantly changes. The accrual of statutory interest charges is the most obvious example. The "meter," so to speak, is always running. Ironically, the United States itself has acknowledged that truism by arguing previously (and successfully) that the amount of a federal tax lien should include interest that is accrued subsequent to assessment. *See Middlesex Savings Bank v. Johnson*, 777 F. Supp. 1024, 1026 n.3 (D. Mass. 1991). In other words, the United States itself has recognized the absurdity of a requirement that a tax lien is only enforceable if and when its precise value is knowable.

The second additional flaw with the argument is that it negates the principle that a tax return, at both the state and federal level, is a declaration and disclosure of liability. *See, e.g.*, Minn. Stat. § 289A.63, subd. 2(a); 26 U.S.C. § 2706(1) (subjecting the untruthful taxpayer to potential criminal penalties for making false statements on a tax return). As discussed above, the Supreme Court's choateness doctrine imposes no requirement of absolute precision at the time of assessment. It mandates only that no contingencies might arise which would hinder enforcement of the lien. Therefore, even assuming that the court of appeals found some element of the United States' argument compelling, it should have held that the State's lien as to the *tax portion* established by the taxpayer's returns was choate. When Prime Factors filed its withholding tax returns on June 2, 1992, it made a disclosure and declaration as to the tax it owed, and thereby assessed itself under Minnesota law. The state made no changes to that tax amount. At the very least, therefore,

the State's liens in the instant matter were unquestionably certain as to the tax amount, the identity of the lienor, and the identity of the property subject to the lien upon filing, and were summarily enforceable at that time. In holding that a tax lien is inchoate *per se* as of the filing of a tax return, the court of appeals in this case went far beyond the established boundaries of this Court's lien priority jurisprudence. Accordingly, the decision of the Eighth Circuit merits review.

## II. The Eighth Circuit Decision Attributes Statutory Absurdities To The Minnesota Legislature.

The Eighth Circuit decision in this case construes Minnesota law in a manner that neither the Minnesota Legislature nor any reasonable legislature could have intended. In it, the court of appeals concluded that even if a tax lien is not inchoate *per se* as of the date of filing it is inchoate under Minnesota law because Minnesota tax statutes purportedly require certain administrative steps which make a taxpayer's true liability as of the filing date unknowable. Specifically, the court determined that the language of two statutory provisions mandates that the State must in each case make some sort of change to a taxpayer's return. App. 9-11. That conclusion is a fundamental misreading of Minnesota law as to the first statute, and is wholly inapplicable to the second statute.

### A. The Court Of Appeals' Reading Of Minn. Stat. § 289A.35 Ignores Core Choateness Principles, Renders Other Minnesota Tax Statutes Superfluous, And Fails To Address The Facts Of This Case.

As this Court has acknowledged, taxation is a state function "central to state sovereignty." *Department of Revenue of Oregon v. ACF Industries*, 510 U.S. 332, 345 (1994); *see also Tully v. Griffin*, 429 U.S. 68, 73 (1976) (according special deference to states' taxing prerogatives). Construction of state taxation statutes by any federal court should account for that fact. Accordingly, the State in this case ought to enjoy a presumption against any interpretation of federal choateness doctrine which nullifies a provision of its tax statutes.

As a general matter, statutes are to be interpreted *in pari materia* with one another. In other words, as this Court has repeatedly emphasized, "When there are two acts upon the same subject, the rule is to give effect to both if possible." *United States v. Zacks*, 375 U.S. 59, 67-68 (1963) (quoting *United States v. Borden Co.*, 308 U.S. 188, 198 (1939)). Minnesota courts have adopted the same cannon of construction. *See, e.g., State v. Lucas*, 589 N.W.2d 91, 94 (Minn. 1999); *State v. McKown*, 475 N.W.2d 63, 66-67 (Minn.), *cert. denied*, 502 U.S. 1036 (1991).

An additional principle of statutory construction is that federal courts have "some 'scope for adopting a restricted rather than a literal or usual meaning of [a statute's] words where acceptance of that meaning would lead to absurd results. . . . ' " *Commissioner of Internal Revenue v. Brown*, 380 U.S. 563, 571 (1965) (citing *Helvering*

*v. Hammel*, 311 U.S. 504, 510 (1941)). As an example, the word "shall" is generally, *but not always*, mandatory. *Escoe v. Zerbst*, 295 U.S. 490, 493 (1935). As to the interpretation of state laws, Minnesota courts have held likewise. *See Heller v. Wolner*, 269 N.W.2d 31, 33 (Minn. 1978) (noting, *inter alia*, that "shall" is directory where statutes "are obviously designed merely to secure order, uniformity, system, and dispatch in public business"); *Carl Bolander & Sons Co. v. Minneapolis*, 488 N.W.2d 804, 809-10 (Minn. Ct. App. 1992), *aff'd*, 502 N.W.2d 203 (Minn. 1993) (holding that the word "shall" is directory "[w]here a statute or rule does not explicitly declare the consequence of a failure to comply"). In fact, Minn. Stat. § 645.17, subd. 1 (1998) commands that in interpreting state statutes, the courts should be guided by the principle that "[t]he legislature does not intend a result that is absurd, impossible of execution, or unreasonable."

The court of appeals' interpretation of Minnesota law would indeed lead to absurd results. The first statute upon which the court relied in its decision is Minn. Stat. § 289A.35, which provides that:

> The commissioner shall make determinations, corrections, and assessments with respect to state taxes, including interest, additions to taxes, and assessable penalties. . . . If a return has been filed, the commissioner shall examine the return and make any audit or investigation *that is considered necessary*.

App. 25 (emphasis added). A common sense reading of this language reveals that the provision merely sets forth the powers of the Minnesota Commissioner of Revenue in the first clause, and merely provides for the discretionary

power to change a tax return in the subsequent clause. The court of appeals concludes that the statute requires action for each and every taxpayer that either changes the amount on the taxpayer's self-assessed tax return or at the very least rises to the level of an administrative step sufficient to create a new "assessment" date. Such a reading would ignore the statutory language limiting such changes to those which are "considered necessary." It would thereby mandate the examination and correction of literally millions of tax returns of varying tax types. This simply is not done by either the Minnesota Department of Revenue or the Internal Revenue Service. The Eighth Circuit's decision further concludes that the quoted language makes self-assessment as of the date of filing impossible. But that cannot be true in light of the undisputed principles of the choateness doctrine. As previously mentioned, the enduring test for choateness is whether a lien is "summarily enforceable" in that no contingencies might hinder the state's right or power to enforce its lien. The State's liens meet that test because Minnesota law makes them summarily enforceable on the date of filing.[5] Once a self-assessed tax return is filed, the resulting lien may immediately be enforced both by levy and by judgment lien foreclosure.[6]

The court of appeals' interpretation of that statute is also a general mischaracterization of Minnesota tax law. The only occasion when the filing of a tax return is *not* the applicable "assessment" date is either "in the case of

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[5] *See* Minn. Stat. § 270.65, § 270.69, subd. 1 and § 270.69, subd. 4 (1992) (App. 24-25).

[6] *See* Minn. Stat. § 270.69, subd. 6 (1992) (App. 25).

taxes determined by the commissioner" (in which case the assessment date is "the date of the order assessing taxes") or "in the case of an amended return" (in which case the assessment date is "the date the [amended] return was filed with the commissioner").[7] Otherwise, as in this case, the "assessment" date is always the date of filing a return.[8] If, as the court of appeals contends, the State must make an independent determination of the accuracy of the tax amount on each and every tax return, then the portion of § 270.65 defining the "assessment" as the date of filing would be utterly superfluous – because *all* returns would supposedly be subject to some additional administrative step. By the terms of the statute, no return date could ever be an "assessment." The Minnesota legislature could not have intended such a result. And such a construction by the court of appeals fails to read Minnesota tax statutes *in pari materia*. In other words, the court of appeals has used one Minnesota tax statute to render part of another Minnesota tax statute meaningless, rather than to clarify its meaning.

Additionally, the Eighth Circuit's holding is not responsive to the facts of this case. If the State had made changes to the tax amount on Prime Factors' returns, or

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[7] *See* Minn. Stat. § 270.65 (1992) (App. 24); *see also* Minn. Stat. § 289A.37, subd. 1(a) (1992) (App. 25), which commands that:

> When a return has been filed and the commissioner determines that the tax disclosed by the return is different than the tax determined by the examination, the commissioner shall send an order of assessment to the taxpayer. . . .

[8] *Id.*

had issued a discretionary penalty of some sort, it would have sent out an order assessing the new amount of tax liability. Under Minnesota law, the date of that order would then have been the new assessment date.[9] But the State never made any adjustments to the self-assessed tax amount on the Prime Factors' returns. The only changes were the automatic additions of penalties for late filing and late payment. *See* II.B, *infra*. Accordingly, the assessment date was the date on which the taxpayer filed its return.

### B. The Court Of Appeals Mischaracterizes The Language Of Minnesota's Late Payment Penalty Statute, And Ignores The Other Penalty Statutes At Issue In This Case.

The second statute that the court of appeals cites is Minnesota's penalty provision for the late *payment* of a withholding tax. That statute, along with the separate statutory provision governing the late *filing* of a withholding tax return, are the two primary penalty provisions at issue in this case. The late payment statute provides that "If a withholding or sales or use tax is not paid within the time specified for payment, a penalty *must be added* to the amount required to be shown as tax." Minn. Stat. § 289A.60, subd. 1 (1992) (Emphasis added). This provision directly contradicts the Eighth Circuit's conclusion that some further administrative action is required before a lien is choate as to the penalties at issue in this case. The quoted language reveals that the penalty

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[9] *Id.*

for late filing of a tax "must be added." The law vests no discretion in the Department of Revenue. The penalty is simply automatic. No administrative step is therefore required to apply the penalty amount to the self-assessed tax amount which a taxpayer discloses on a tax return.

Tellingly, the court of appeals does not quote any language whatsoever from the second of the two penalty provisions at issue in this case, which is Minnesota's late *filing* penalty. The language in effect during 1992 is even *more* direct than the language in the aforementioned late *payment* penalty provision. The statute provides that "If a taxpayer fails to make and file a return other than an income tax return of an individual, within the time prescribed or an extension, a penalty *is added* to the tax." Minn. Stat. § 289A.60, subd. 2 (1991 Supp.). A penalty that "is added" to a tax can not require any sort of administrative step. Like the late payment penalty, the late filing penalty is simply automatic. It is difficult to conceive of language that would be more direct.

Other provisions of Minnesota tax law recognize that automatic penalties, such as the late filing and late payment penalties at issue in the instant case, arise automatically upon the filing of a tax return. The language of Minn. Stat. § 289A.55, subd. 9(a) (1990), for example, provides that a penalty for either late filing or late payment "bears interest *from the date the return* or payment *was required to be filed or paid*, including any extensions, to the date of payment of the penalty." (Emphasis added). The court of appeals' decision holds that automatic penalties, with automatic interest charges dating from the date of a tax return, frustrate the choateness of a tax lien

because they somehow require additional administrative steps. That holding is untenable.

Ultimately, no Minnesota statute interferes with the summary enforceability of the State's tax liens in this case. Prime Factors filed its returns on June 2, 1992. Certain penalties accrued automatically, as did the statutory interest charges. The unchanged self-assessed tax amount together with the automatic penalties were therefore enforceable as of the filing date. Accordingly, the court of appeals should have held that the State tax liens were choate as of June 2, 1992, and were prior and superior to the IRS liens.

## CONCLUSION

For all the foregoing reasons, the State respectfully requests that the Court grant this petition.

Dated: October 5, 1999

Respectfully submitted,

BARRY R. GRELLER
Assistant Attorney General
(*Counsel of Record*)

STEPHEN F. SIMON
Assistant Attorney General
(*Of Counsel*)

600 North Robert Street,
Suite 4000
St. Paul, MN 55146-0600
Telephone: (651) 296-0982

*Attorneys for Petitioner*

**APPENDIX**

**United States Court of Appeals**
FOR THE EIGHTH CIRCUIT

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No. 98-1927

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| State of Minnesota, Department of Revenue, Appellee, | * | |
| v. | * | Appeal from the United States District Court for the District of Minnesota |
| United States of America, Appellant. | * | |

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Submitted: February 8, 1999

Filed: July 7, 1999

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Before McMILLIAN, LAY and MURPHY, Circuit Judges.

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McMILLIAN, Circuit Judge.

The United States appeals from a final order entered in the District Court for the District of Minnesota granting summary judgment in favor of the State of Minnesota and denying summary judgment to the United States, holding that the state tax liens were choate, as of the time of filing of the state tax returns and not when processed. For reversal, the United States argues that the state tax liens were not established at the time the state tax returns were filed because, under state law, the state must take

administrative action to acknowledge taxpayer liability before its liens can be perfected, and thus "choate," under federal law for purposes of determining relative priority. For the reasons discussed below, we reverse the judgment of the district court and remand the case to the district court with directions to enter summary judgment in favor of the United States.

## JURISDICTION

The district court had subject matter jurisdiction over this wrongful levy suit brought pursuant to 26 U.S.C. § 7426 under 28 U.S.C. § 1346(e). The United States filed a timely notice of appeal. *See* 28 U.S.C. § 2107(b) (notice of appeal in a civil case must be filed within 60 days of judgment when the United States is a party); Fed. R. App. P. 4(a)(1)(B). This court has jurisdiction over this appeal under 28 U.S.C. § 1291.[1]

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[1] The district court's judgment provides that the state's motion for summary judgment is granted. In an action for money, specification of the amount of monetary award generally is an essential element of the judgment. *See United States v. F. & M. Schaefer Brewing Co.*, 356 U.S. 227, 233-35 (1958). It is sufficient, however, if the judgment specifies the means of determining the amount due. *See id.* at 234. Here, the summary judgment is, in effect, a judgment that the state is entitled to recover the amount ($14,378) that it sought in its complaint. *Cf. Goodwin v. United States*, 67 F.3d 149, 151 (8th Cir. 1995) ("a judgment may be final if only ministerial tasks in determining damages remain") (citation and internal quotations omitted).

## BACKGROUND

The relevant facts were stipulated. On June 2, 1992, the taxpayer, Prime Factors Communications, Inc., filed federal and state employment tax returns for several quarters, including all four quarters of 1991 and the first quarter of 1992, the periods at issue in this appeal. The taxpayer did not pay the taxes that it reported as due on its federal and state returns. The IRS assessed the unpaid federal taxes for the quarters at issue on August 3 and August 10, 1992. By law, federal tax liens upon the taxpayer's property for those liabilities arose on that date. *See* 26 U.S.C. §§ 6321, 6322. The IRS filed a notice of federal tax lien on January 14, 1993, reflecting a total federal tax liability due from the taxpayer of $248,658.33.

The state processed the taxpayer's state employment tax returns for the period at issue by entering the taxpayer's liability into its computer records, on August 20, 1992, after the date the IRS assessed the taxpayer's federal tax liabilities at issue. The taxpayer's state tax liability for the period at issue totaled $14,378.32.

On June 21, 1996, Charles and Lorilee Leininger purchased certain property belonging to the taxpayer. Prior to the sale, the IRS served on the closing agent for the sale a notice of levy with respect to the taxpayer's unpaid federal employment taxes, including the taxes due for the quarters at issue. Pursuant to the levy, the IRS received $14,579.22 of the sale proceeds.[2]

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[2] The IRS was paid after deductions were made for settlement charges, delinquent property taxes, and payments to other creditors. The Minnesota Department of Economic

The state filed its complaint in this action on March 3, 1997, and an amended complaint on September 23, 1997. The state alleged that the IRS had wrongfully levied upon $14,378.32 of the sales proceeds, because the state's tax liens were entitled to priority over the federal tax liens. The United States and the state filed cross-motions for summary judgment. The state contended that, under Minn. Stat. § 270.69(1), a lien for state taxes arises on the date of the assessment of the tax, and that under Minn. Stat. § 270.65, the date of the assessment is the later of the date the return is filed or the date on which the return is due. The state thus argued that its tax liens became choate, on June 2, 1992, the date the returns were filed, and were therefore entitled to priority over the federal tax liens which arose on August 3 and 10, 1992, the dates the federal taxes were assessed. In support of its argument, the state relied on *Cannon Valley Woodwork, Inc. v. Malton Construction Co.*, 866 F.Supp. 1248 (D. Minn. 1994) (*Cannon Valley*), a case in which the district court held that Minnesota tax liens had priority over those of the United States.

The United States argued that the state's tax liens did not become choate, until the returns were actually processed by the state on August 20, 1992, a date after the federal tax liability had been assessed, and that the federal tax liens were thus entitled to priority over the state tax liens. The United States relied on *In re Priest*, 712 F.2d 1326, 1329 (9th Cir. 1983), *modified*, 725 F.2d 477 (1984), in

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Security received $16,386.40 and the Minnesota Department of Revenue received $3,723.34 for other tax liabilities. These other payments from the proceeds are not in dispute.

which the Ninth Circuit, interpreting a California statute similar to Minn. Stat. §§ 270.65, .69(1), held that the "mere receipt" of a state tax return was insufficient "to establish a lien that is capable of taking priority over a federal lien."

Following arguments on the motions, the district court ruled from the bench and granted summary judgment in favor of the state and denied the motion of the United States. The district court found that the state's tax liens became choate upon the filing of the taxpayer's returns, adopting the rationale of *Cannon Valley* and rejecting the Ninth Circuit's reasoning in *In re Priest*. The district court ruled that the state's tax liens were "established" and "summarily enforceable" as of the date the taxpayer filed its returns and "not contingent on future events." Accordingly, the district court ruled that the state's tax liens were prior to those of the United States and that the state was entitled to recover. This appeal followed.

## DISCUSSION

The district court's grant of summary judgment is reviewed *de novo*. *See Bremen Bank & Trust Co. v. United States*, 131 F.3d 1259, 1264 (8th Cir. 1997) (*Bremen Bank*); *see also McDermott v. Zions First Nat'l Bank*, 945 F.2d 1475, 1478 (10th Cir. 1991) (district court's finding that a federal tax lien has priority over a state tax lien is reviewed *de novo*), *rev'd on other grounds sub nom. United States v. McDermott*, 507 U.S. 447 (1993) (*McDermott*). Summary judgment is appropriate if "the pleadings, depositions, answers to interrogatories, and admissions on file,

together with the affidavits, if any, show that there is no genuine issue as to any material fact and that the moving party is entitled to a judgment as a matter of law." Fed. R. Civ. P. 56(c). This case was tried on the basis of stipulated facts and the sole issue is a question of law, that is, whether the state tax liens were sufficiently choate as a matter of federal law so as to be entitled to priority over the federal tax liens.

The lien provisions of the Internal Revenue Code are intended to insure prompt and certain enforcement of the tax laws. *See United States v. National Bank of Commerce*, 472 U.S. 713, 721 (1985); *United States v. Rodgers*, 461 U.S. 677, 683 (1983). When a person liable to pay a federal tax fails to do so after a demand for payment is made, the amount of the tax, together with interest, additions, penalties, and costs, becomes a lien in favor of the United States upon all real and personal property and all rights to property belonging to the delinquent taxpayer. *See* 26 U.S.C. § 6321; *Bremen Bank*, 131 F.3d at 1262-63. The lien arises automatically when the assessment is made and continues until the taxpayer's liability is either satisfied or becomes unenforceable due to the lapse of time. *See* 26 U.S.C. § 6322. An assessment is "a bookkeeping notation . . . made when the Secretary [of the Treasury] or his [or her] delegate establishes an account against the taxpayer on the tax rolls." *Laing v. United States*, 423 U.S. 161, 170 n.13 (1976); *see* 26 U.S.C. § 6203.

State law determines the nature and the extent of a taxpayer's interest in "property." *See Aquilino v. United States*, 363 U.S. 509, 513 (1960); *United States v. Bess*, 357 U.S. 51, 55 (1958); *Little v. United States*, 704 F.2d 1100, 1105 (9th Cir. 1983). Federal law, however, governs the

relative priority accorded to the competing liens asserted against the property of the delinquent taxpayer. *See Aquilino v. United States*, 363 U.S. at 513-14. "Federal tax liens do not automatically have priority over all other liens. Absent provision to the contrary, priority for purposes of federal law is governed by the common-law principle that 'the first in time is the first in right.' " *McDermott*, 507 U.S. at 449 (citations omitted); *see United States v. Equitable Life Assurance Soc'y*, 384 U.S. 323, 327-30 (1966); *United States v. City of New Britain*, 347 U.S. 81, 87 (1954) (*New Britain*); *cf. Bremen Bank*, 131 F.3d at 1263 (discussing modification of common law rules by Federal Tax Lien Act of 1966). "Under federal law, the priority of a lien depends on the time the lien attached to the property in question and became choate." *Cannon Valley*, 866 F. Supp. at 1250, *citing New Britain*, 347 U.S. at 84. A state-created lien is "choate" for "first in time" purposes only when it has been "perfected" in the sense that there is nothing more to be done, *i.e.*, when "the identity of the lienor, the property subject to the lien, and the amount of the lien are established." *New Britain*, 347 U.S. at 84; *accord United States v. Vermont*, 377 U.S. 351, 354-55 (1965); *see also McDermott*, 507 U.S. at 449. The test for choateness or perfection also requires that the creditor have the right to summarily enforce its lien. *See United States v. Vermont*, 377 U.S. at 359 (holding state's assessment choate where the "assessment is given the force of a judgment, and if the amount assessed is not paid when due, administrative officials may seize the debtor's property to satisfy the debt") (quoting *Bull v. United States*, 295 U.S. 247, 260 (1935)); *Monica Fuel, Inc. v. IRS*, 56 F.3d 508, 513 (3d Cir. 1995); *In re Terwilliger's Catering Plus, Inc.*, 911 F.2d 1168,

1176 (6th Cir. 1990) (holding a "state lien holder must show that he [or she] had the right to enforce the lien at some time prior to the attachment of the federal lien"), *cert. denied*, 501 U.S. 1212 (1991).

The issue to be decided in this case is whether, under federal law, the state tax liens were sufficiently choate upon the taxpayer's filing of its tax returns to prime the federal tax liens. The United States argues that, regardless of state law, the mere receipt by the state of a tax return is insufficient to meet the federal standard for choateness, because such receipt does not establish the amount of the taxpayer's liability or of the liens themselves. Under Minnesota law, the United States contends, additional steps are required to establish the amount of the state tax liens and to permit the state to enforce the liens, and federal law regarding choateness requires a state to take some action to acknowledge a liability before a lien can be perfected. As a result, the United States argues that the state tax liens were not perfected and were not entitled to priority over the federal liens.

The state tax liens at issue arose by virtue of Minnesota law, which provides, in relevant part:

> The tax imposed by any chapter administered by the commissioner of revenue, and interest and penalties imposed with respect thereto, including any recording fees, sheriff fees, or court costs that may accrue, shall become a lien upon all the property within this state, both real and personal, of the person liable for the payment or collection of the tax . . . from and after the date of assessment of the tax.

Minn. Stat. § 270.69(1). "For purposes of taxes administered by the commissioner [*i.e.*, taxes due as shown on a return], the term 'date of assessment' means the date a return was filed or the date a return should have been filed, whichever is later. . . . " *Id.* § 270.65. Thus, under state law, the state tax liens at issue arose when the taxpayer filed its returns on June 2, 1992, two months before the federal taxes at issue were assessed.

State law, however, and a state's own characterization of its liens for purposes of determining priority do not control this issue. *See* William T. Plumb, Jr., Federal Tax Liens 180 (3d ed. 1972) ("Local statutory provisions that fix a tax lien date prior [to the time the lien becomes choate] must be ignored for the purpose of resolving the federal-state priority question."). "Otherwise, a State could affect the standing of federal liens, contrary to the established doctrine, simply by causing an inchoate lien to attach at some arbitrary time even before the amount of the tax, assessment, etc., is determined." *New Britain*, 347 U.S. at 86 (footnote omitted). Accordingly, state tax liens are not necessarily perfected on the date a taxpayer files a return simply because state law provides that the "date of assessment" with regard to taxes shown due on a return is the date the return is filed. Rather, we must still determine if the state tax liens are sufficiently perfected as of that date under federal law.

In our view, the state tax liens at issue were not choate as of the date the taxpayer filed its returns and the state tax liens therefore are not entitled to priority. Despite the fact that state law provides that tax liens arise on the date on which the taxpayer filed its returns, state law also provides that "[t]he commissioner *shall* make

determinations, corrections, and assessments with respect to state taxes, including interest, additions to taxes, and assessable penalties." Minn. Stat. § 289A.35 (emphasis added). In addition, when a taxpayer has filed a return, "the commissioner shall examine the return and make any audit or investigation that is considered necessary." *Id.* Therefore, even after a return is filed, the commissioner is required to examine the return and to make a determination of the taxpayer's liability. Beyond doubt, it is this determination that formally establishes the amount of the taxpayer's liability.

Further, Minnesota law also provides that "[i]f a withholding or sales or use tax is not paid within the time specified for payment, a penalty must be added to amount required to be shown as tax." Minn. Stat. § 289A.60(1). Therefore, in a case such as this where withholding taxes were not timely paid, state law required the commissioner to add a penalty to the tax liability. This penalty is not computed until a tax return is processed. *Cannon Valley*, 866 F. Supp. at 1252. Also upon processing, interest due on the liability is computed.

As a result of these state law provisions, we hold that the amounts of the state tax liens at issue here were not established on the date the returns were filed and that state tax liens were therefore not perfected and choate on that date. The returns filed by the taxpayer had not been examined, the taxes owed had not been determined by the commissioner, and the delinquency penalties and interest had not been computed and added to the amount of the tax, all of which is required under state law. Thus, pursuant to state law, the state has done that which is

expressly prohibited, that is, it has "affect[ed] the standing of federal liens . . . simply by causing an inchoate lien to attach at some arbitrary time even before the amount of the tax is determined." *New Britain*, 347 U.S. at 86.

Moreover, we also note that because of these additional statutory provisions, the state tax liens were not summarily enforceable. While a lien is considered summarily enforceable even though ministerial acts which do not affect the viability of the lien remain to be done, the acts described above as required by state law cannot be characterized as ministerial. After the taxpayer filed its returns, it remained the statutory duty of the commissioner to examine the returns and determine its liabilities, and to calculate and add to the unpaid tax the required penalty for non-payment and the interest that was due. Only then could notice and demand for payment of the amount due be sent. *See* Minn. Stat. § 270.70(2)(a). Notice and demand for payment must be sent before a levy can be made. *See id.* Thus, substantial contingencies remain before the state tax liens could be enforced.

We note that, in addition to the requirements of state law, federal law regarding choateness also requires that a state take some administrative action to acknowledge formally a liability before the amount of the lien can be deemed "established" and the lien perfected. *See New Britain*, 347 U.S. at 86. For example in *In re Priest*, a California statute provided that a perfected and enforceable state tax lien for an unpaid tax liability shown as due on a return arose at the time the tax return was filed. California characterized the effect of the filing of the delinquent state return as "self assessment" and argued that this admission of liability by the taxpayer satisfied

the *New Britain* test for choateness. The Ninth Circuit disagreed and held that the statute cannot be deemed to create liens that are sufficiently choate under *New Britain*. *See* 712 F.2d at 1329. The court held that "a lien cannot arise prior to the taking of any administrative steps to establish the lien" because "[t]he mere receipt of a delinquent State tax return [under California law] is too vague and indefinite." *Id.*, 725 F.2d at 478. The court observed that

> [s]ignificant delays might well occur before there was even any acknowledgment of the director's receipt of the delinquent return, or any administrative act by which the State acknowledged in its own accounts that the taxpayer is liable for unpaid taxes, or the precise amount of that delinquency, and the amount of penalty, interest and fees.

*Id.*, 712 F.2d at 1329.

*In re Priest* has been followed by other courts. In *Baybank Middlesex v. Electronic Fabricators, Inc.*, 751 F. Supp. 304, 310 (D. Mass. 1990) (citations omitted), the district court held that "in order for the amount of the state lien to be established, there must be 'some activity by the State to fix the taxpayer's liability.' " The state liens at issue had priority over the federal liens because the state had acknowledged in its own accounts that the taxpayer was liable for unpaid taxes. *See id.* The district court also noted approvingly that the state had calculated the interest due on the liability and included that amount in the notice of lien. *See id.* Because these steps had been taken before the federal lien arose, the state lien was choate since there was nothing more to be done. *See id.*

As noted above, the district court relied upon *Cannon Valley*, 866 F. Supp. 1248, and declined to follow *In re Priest*. *Cannon Valley* involved the same statutes at issue in this case, *i.e.*, Minn. Stat. §§ 270.65, .69. The district court concluded that a lien arising under the statutes was choate under federal law at the time of assessment, the date a tax return was filed. *See* 866 F. Supp. at 1252. The district court rejected the argument of the United States that a state assessment was only choate if it was similar to the federal assessment, *see id.* at 1250-51, as well as its contention that, as in *In re Priest*, preciseness in the amount of tax owed is necessary for the lien to be choate. *See id.* at 1251. Instead, the district court interpreted the doctrine of choateness to require that "a lien be enforceable and not contingent on future events before it could defeat a federal tax lien." *Id.* at 1251. The district court found that under state law Minnesota tax liens were not contingent on future events and were summarily enforceable and therefore choate. *See id.*

We believe the analysis in *Cannon Valley* improperly discounted the importance of preciseness in the amount of tax owed in the *New Britain* test for choateness. In our view, the plain language of *New Britain* requires the amount of the lien to be established, that is, determined, before a state-created lien can be considered choate. *See* 347 U.S. at 84. Certainly, more had to be done in the present case, and if the Supreme Court had intended to require only that the lien, *i.e.*, the taxpayer's liability in general, had to be established, it could have said so. Instead, it stated that the amount of the lien had to [sic] established. Moreover, in both *New Britain* and *Vermont*, the Court refers to the requirement that the amount of the

lien be "certain." *See id.* at 86; *see also Vermont*, 377 U.S. at 357. The Ninth Circuit was therefore correct in emphasizing this requirement in *In re Priest* and the district court in *Cannon Valley* was wrong to discount it.

In addition, we disagree with the finding in *Cannon Valley* that the Minnesota tax liens were free from contingencies upon the taxpayer's filing of its return and summarily enforceable. *See supra* at 7-8. In our view, state law requires additional administrative action to establish the liens. The taxpayer's liabilities could not be collected until notice of the liabilities and demand for payment had been sent out, and notice and demand could not be sent until the returns had been processed and the tax, penalties, and interest determined by the commissioner. Thus, the state tax liens are not summarily enforceable on the date of assessment, the date the return is filed or should have been filed.

Finally, we note that there is a critical factual distinction between *Cannon Valley* and the present case. In *Cannon Valley*, unlike the present case, the state had in fact "processed" the taxpayer's return before the IRS assessed the federal taxes. *See* 866 F. Supp. at 1249 n.1, 1252. The district court in *Cannon Valley* held, in the alternative, that at the very least, the state tax liens were choate at the time the returns were processed, noting that "[b]y processing the forms, Minnesota took administrative action that established that the taxpayer was liable to the State of Minnesota for unpaid taxes, including the amount of the unpaid taxes and the amount of any penalty and interest." *Id.* at 1252. Thus, for purposes of the *New Britain* test for choateness, "the lienor was known . . . , all of the property of the taxpayer was attached, and the

amount including principal, penalties and interest was known." *Id.* (noting only variable that continued to change was applicable interest, which changed daily). Accordingly, while the primary rationale for the *Cannon Valley* analysis is at odds with that in *In re Priest*, the result (and the alternative holding) in Cannon Valley is in harmony with *In re Priest*. In the present case, on the other hand, the state did not process the taxpayer's returns until August 20, 1992, a date after the IRS assessed the federal taxes on August 3 and August 10, 1992.

Accordingly, the judgment of the district court is reversed and the case is remanded with instructions to the district court to enter summary judgment in favor of the United States.

A true copy.

Attest:

CLERK, U.S. COURT OF APPEALS, EIGHTH CIRCUIT.

UNITED STATES DISTRICT COURT
DISTRICT OF MINNESOTA
FOURTH DIVISION

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Department of Revenue,
State of Minnesota,

Plaintiff,

vs.

United States of America,

Defendant.

Civil 97-482
TRANSCRIPT OF
PROCEEDINGS

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The above-entitled matter came duly on for hearing before the Honorable James M. Rosenbaum on the 23rd day of January, 1998, at the U.S. Courthouse, 300 South Fourth Street, City of Minneapolis, State of Minnesota.

APPEARANCES:

For the Plaintiff:

STEPHEN F. SIMON, AAG
Tax Litigation Division
10 River Park Plaza
Mail Station 0600
St. Paul, Minnesota 55146-0600

For the Defendant:

NANCI S. BRAMSON, ESQ.
U.S. Department of Justice
555 Fourth Street, Northwest
Room 8921
Washington, DC 20001

Court Reporter:

Michelle K. Skoog, Pro Tem
Shaddix & Associates
9100 W. Bloomington Frwy., #122
Bloomington, Minnesota 55431

Proceedings recorded by mechanical stenography; transcript produced by computer-aided transcription.

[p. 2] (The following proceedings were duly had:)

THE COURT: This matter lies before the court on cross-motions for summary judgment pursuant to Rule 56 of the Federal Rules of Civil Procedure. The plaintiff's motion is granted. The defendant's motion is necessarily denied. The plaintiff, the State of Minnesota, Department of Revenue has brought a wrongful levy action against the defendant, the United States of America, and specifically, its agency the Internal Revenue Service. The court seldom has the pleasure of a direct conflict between sovereigns. Now, the parties here have, and have commendably and kindly to the court I might point out, stipulated to the material facts in the case. And they are not in dispute. The state contends that its lien is sufficiently choate on the filing of a tax return, and the IRS responds that the lien becomes choate on the date at which the return is actually processed by the state. The issue before the court is whether the state's lien became sufficiently choate on June 2, 1992, at the time of the filing. Thus, making it superior to the federal tax lien which was undoubtedly and an [p. 3] agreement was in place prior to this date on August 20, 1992, to the state filing in 1992. The fed put its in on the third – the third or

tenth of 1992. Each party has moved for summary judgment and the question is clearly a matter of law.

Summary judgment is appropriate when there's no genuine issue as to material fact and the moving party is otherwise entitled to judgment as a matter of law. Citing Rule 56C and Celotex versus Catrett and Anderson versus Liberty Lobby. Both recorded in 477 U.S. The first is 317, and the second is 242 with the companion cases decided in 1986. There being no issues of fact and the question being a matter of law, the matter is ripened for summary judgment.

It is clear and well established that federal law determines the question of priority among liens. Citing Aquilano versus United States at 363 U.S. 509, 513 to 14 (1960). Under federal law, quoting, a prior lien gives a prior claim, which is entitled to prior satisfaction out of the subject it binds close quote. Citing the United States versus New Britain at 347 U.S. 81 and at 85 (1954). Rendering the entirely unsurprising – or [p. 4] quoting that first in time is first in right close quote. That's at 85. A lien has priority over another if it is perfected. Or in other words, quote the identity of the lienor, the property subject to the lien, and the amount of the lien are established. Reference New Britain at 84. Where state tax liens are involved, however, the enforceability requirement is met if quote the states' assessment is given the force of a judgment, i.e. if the amount assessed is not paid when due, administrative officials may seize the property to satisfy the debt close quote. The United States versus Vermont at 377, 351, at 359 (1950). It is thus implied that to determine enforceability the court must look to the

state's law, and the parties here disagree only as to the time which the state's lien was established.

The facts in this case are similar to those which occurred in my brother Judge Doty's court when he was confronted with the case of Cannon Valley Woodwork versus Malton Construction at 866 Fed Supp 1248, District of Minnesota in 1994. Although a binding of a co-district court is not binding within the district, this court elects to adopt its analysis and its holding. In [p. 5] that case, the court found that the amount of the lien was established and its amount assessed when the state tax return was filed rather than when it was processed. I cite the case at 1250. The Internal Revenue Service's underlined that Cannon Valley was wrongfully decided because the amount of the lien could be assessed only upon actual processing of the return. They argued that only after that return was processed that the total amount of the tax liability established rather than when it was filed, and certainly there was a failure to determine the interest. However, that upholds under any circumstances. This court, however, cannot agree. The rationale behind the choatness doctrine, which requires that the amount of the lien be established, is to ensure the lien is not subject to contingencies which might render it otherwise unenforceable. I cite the United States versus Vermont at 355. Also, in Cannon Valley, Judge Doty recognized that the state's liens are not contingent on future events when filed because they are summarily enforceably under Minnesota Statute at filing. Furthermore, under Minnesota law when a return is filed, it contains the taxpayers' disclosure of its tax liabilities. [p. 6] I reference page 1251. And as a result, the state lien dating – this state lien

dating from the time of filing is assessed, perfected, and thus senior to the federal tax lien. This is in accord with the policy of a self-assessed tax.

While the court has considered what would happen with either a minor determination or a minor deviation and a large tax assessment or a stripped blank tax return being filed, that is not the factual nexus which represents itself. So it's a varied filed return, and Minnesota has elected a statutory framework which declares that its lien is established on the filing.

Counsel for the government has appropriately noted that the United States has a number of prerogatives and that Congress has selected its own. But having made that selection and the state – another co-sovereign having elected its, there is no principled basis why the State of Minnesota cannot enforce its statute, and the statute appears to be reasonable.

This court, like Cannon Valley, then declines to adopt the Ninth Circuit reasoning set forth in In re Priest at 712 Fed 2nd at 1326, at 1328. Subsequently modified at 725 Fed 2nd 477. [p. 7] That was in – that holding – that quote a mere receipt of a delinquent tax return is too vague and indefinite a standard by which to establish a lien that is capable of taking priority over a federal tax lien close quote. The Ninth Circuit's determination was based on the language of New Britain, that a lien is not choate unless the amount is established. This court finds that since Minnesota's tax liens were not contingent on future events according to Minnesota law and by operation of the state statute which were summarily enforceable, they were established, they were choate, and thus satisfying

New Britain's test. And therefore, the government's – the federal government's motion for summary judgment was denied. They denied that case and remanded it.

I will be frank to tell you that I have enjoyed the argument of both counsel. Each appeared to be well familiar with their law and quite flexible with their reasoning. That does not mean that they were not staunch in their defense, but it told me they considered the alternative. It's an interesting question, and there is – on these facts and then considering [p. 8] the Minnesota Statute and the statutory structures set forth by the Minnesota State Legislature, the determination is made and to indicated and that will be the order of the court. I thank you, counsel.

(The proceedings were concluded.)

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UNITED STATES DISTRICT COURT
DISTRICT OF MINNESOTA
97-CV-482

| | | |
|---|---|---|
| State of Minnesota,<br>Department of Revenue | ) | ORDER |
| v. | ) | |
| United States of America | ) | |

This matter is before the Court on the parties' cross-motions for summary judgment, pursuant to Rule 56 of the Federal Rules of Civil Procedure. The Court heard oral argument on January 23, 1998. Based on the files, records, and proceedings herein, IT IS ORDERED that:

1. Plaintiff's motion for summary judgment is granted.

2. Defendant's motion for summary judgment is denied.

Dated: January 28th, 1998

/s/ James M. Rosenbaum
JAMES M. ROSENBAUM
United States District Judge

**UNITED STATES DISTRICT COURT**

**DISTRICT OF MINNESOTA**

State of Minnesota,
Department of Revenue Case No. Civil 97-482JMR/FLN

v. **JUDGMENT IN A CIVIL CASE**

United States of America

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( ) **Jury Verdict.** This action came before the Court for a trial by jury. The issues have been tried and the jury has rendered its verdict.

(X) **Decision by Court.** This action came to trial or hearing before the Court. The issues have been tried or heard and a decision has been rendered.

**IT IS ORDERED AND ADJUDGED** that plaintiff's motion for summary judgment is granted and defendant's motion for summary judgment is denied.

DATE: January 29, 1998

FRANCIS E. DOSAL, CLERK

/s/ Denise LaFond, Deputy Clerk

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Minn. Stat. § 270.65 (1992):

> For purposes of taxes administered by the commissioner, the term "date of assessment" means the date a return was filed or the date a return should have been filed, whichever is later; or, in the case of taxes determined by the commissioner, "date of assessment" means the date of the order assessing taxes; or in the case of an amended return filed by the taxpayer, the assessment date is the date the return was filed with the commissioner.

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Minn. Stat. § 270.69, subd. 1 (1992):

> The tax imposed by any chapter administered by the commissioner of revenue, and interest and penalties imposed with respect thereto, including any recording fees, sheriff fees, or court costs that may accrue, shall become a lien upon all the property within this state, both real and personal, of the person liable for the payment or collection of the tax, except property exempt under subdivision 3, from and after the date of assessment of the tax.

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Minn. Stat. § 270.69, subd. 4 (1992):

> The lien imposed by this section shall, notwithstanding any other provision of law to the contrary, be enforceable from the time the lien arises and for ten years from the date of filing the notice of lien, which must be filed by the

commissioner within five years after the date of the assessment of the tax. . . .

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Minn. Stat. § 270.69, subd. 6 (1992):

The lien imposed by this section shall be enforceable by levy as authorized in section 270.70, or by judgment lien foreclosure as authorized in chapter 550.

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Minn. Stat. § 289A.35 (1992):

The commissioner shall make determinations, corrections, and assessments with respect to state taxes, including interest, additions to taxes, and assessable penalties. . . . If a return has been filed, the commissioner shall examine the return and make any audit or investigation that is considered necessary.

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Minn. Stat. § 289A.37, subd. 1(a) (1992):

When a return has been filed and the commissioner determines that the tax disclosed by the return is different than the tax determined by the examination, the commissioner shall send an order of assessment to the taxpayer. . . .

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Minn. Stat. § 289A.55, subd. 9(a) (1992):

> [B]ears interest from the date the return or payment was required to be filed or paid, including any extensions, to the date of payment of the penalty.

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Minn. Stat. 289A.60, subd. 1 (1992):

> If a withholding or sales or use tax is not paid within the time specified for payment, a penalty must be added to the amount required to be shown as tax.

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Minn. Stat. § 289A.60, subd. 2 (1992):

> If a taxpayer fails to make and file a return other than an income tax return of an individual, within the time prescribed or an extension, a penalty is added to the tax.

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Minn. Stat. § 645.17, subd. 1 (1998):

> [t]he legislature does not intend a result that is absurd, impossible of execution, or unreasonable.

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Supreme Court, U.S.
FILED
DEC 2 - 1999
OFFICE OF THE CLERK

No. 99-597

# In the Supreme Court of the United States

STATE OF MINNESOTA, DEPARTMENT OF REVENUE,
PETITIONER

*v.*

UNITED STATES OF AMERICA

*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT*

## BRIEF FOR THE UNITED STATES IN OPPOSITION

SETH P. WAXMAN
*Solicitor General*
*Counsel of Record*
LORETTA C. ARGRETT
*Assistant Attorney General*
BRUCE R. ELLISEN
RANDOLPH L. HUTTER
*Attorneys*
*Department of Justice*
*Washington, D.C. 20530-0001*
*(202) 514-2217*

## QUESTION PRESENTED

Whether a state tax lien took priority over a federal tax lien that arose before the state taxes were administratively determined and assessed.

## TABLE OF CONTENTS


| | Page |
|---|---|
| Opinions below | 1 |
| Jurisdiction | 1 |
| Statement | 1 |
| Argument | 4 |
| Conclusion | 11 |


## TABLE OF AUTHORITIES

Cases:


| | |
|---|---|
| *Aquilino* v. *United States*, 363 U.S. 509 (1960) | 4 |
| *Bay State York Co., In re*, 204 B.R. 277 (Bankr. D. Mass. 1996) | 10 |
| *Baybank Middlesex* v. *Electronic Fabricators, Inc.*, 751 F. Supp. 304 (D. Mass. 1990) | 10 |
| *Brown* v. *Maryland*, 699 F. Supp. 1149 (D. Md. 1987), aff'd, 862 F.2d 869 (4th Cir. 1988) | 10 |
| *Bull* v. *United States*, 295 U.S. 247 (1935) | 5 |
| *Cannon Valley Woodwork, Inc.* v. *Malton Constr. Co.*, 866 F. Supp. 1248 (D. Minn. 1994) | 3, 7, 9 |
| *Michigan* v. *United States*, 317 U.S. 338 (1943) | 5 |
| *Middlesex Sav. Bank* v. *Johnson*, 777 F. Supp. 1024 (D. Mass. 1991) | 10 |
| *Priest, In re*, 712 F.2d 1326 (1983), modified, 725 F.2d 477 (9th Cir. 1984) | 3, 10 |
| *United States* v. *City of New Britain*, 347 U.S. 81 (1954) | 4, 6, 7, 9, 10 |
| *United States* v. *McDermott*, 507 U.S. 447 (1993) | 4 |
| *United States* v. *Security Trust & Sav. Bank of San Diego*, 340 U.S. 47 (1950) | 5 |
| *United States* v. *Vermont*, 317 F.2d 446 (2d Cir. 1963), aff'd, 377 U.S. 351 (1964) | 5, 7, 8 |

Statutes: Page

Internal Revenue Code (26 U.S.C.):
26 U.S.C.:
§ 6321 ..... 2
§ 6322 ..... 2
§ 7426(a)(1) ..... 2
Minn. Stat. (West 1999):
§ 270.65 ..... 3
§ 270.69(1) ..... 3
§ 270.70(2)(a) ..... 7
§ 289A.35 ..... 6
§ 289A.60 ..... 7

Miscellaneous:

William T. Plumb, Jr., *Federal Tax Liens* (3d ed. 1972) ..... 6

# In the Supreme Court of the United States

No. 99-597

STATE OF MINNESOTA, DEPARTMENT OF REVENUE,
PETITIONER

*v.*

UNITED STATES OF AMERICA

*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT*

## BRIEF FOR THE UNITED STATES IN OPPOSITION

### OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1-15) is reported at 184 F.3d 725. The opinion of the district court (Pet. App. 16-21) is unreported.

### JURISDICTION

The judgment of the court of appeals was entered on July 7, 1999. The petition for a writ of certiorari was filed on October 5, 1999. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

### STATEMENT

1. On June 2, 1992, a taxpayer named Prime Factors Communications, Inc., filed federal and state employment tax returns for all four quarters of 1991 and the first quarter of 1992. The taxpayer did not, however,

pay the taxes reported on these federal and state returns. The Internal Revenue Service assessed the unpaid federal taxes for those quarters on August 3 and August 10, 1992. On the dates of these assessments, federal tax liens to secure the payment of those taxes arose upon "all property and rights to property" belonging to the taxpayer. 26 U.S.C. 6321. See 26 U.S.C. 6322. On January 14, 1993, the Internal Revenue Service filed a notice of these federal tax liens which reflected that a total federal tax liability of $248,658.33 was then due from the taxpayer. Pet. App. 3.

The Minnesota Department of Revenue (petitioner) processed the taxpayer's state employment tax returns for these same quarters and entered the taxpayer's liabilities into its computer records on August 20, 1992. That was ten days *after* the Internal Revenue Service assessed the federal tax liabilities and the federal tax lien attached to all of the taxpayer's property by operation of federal law. Petitioner determined that the taxpayer's state tax liability for the periods at issue totaled $14,378.32. Pet. App. 3.

On June 21, 1996, certain property that belonged to the taxpayer was sold to a third party. Prior to the closing of this sale, the Internal Revenue Service served a notice of levy directing the closing agent to disburse any funds received on behalf of the taxpayer to the federal government. Pursuant to that levy, the Internal Revenue Service received $14,579.22 of the sale proceeds, which it applied against the taxpayer's obligations. Pet. App. 3.

2. The Minnesota Department of Revenue then brought this wrongful levy action against the United States under 26 U.S.C. 7426, alleging that the state tax lien for the periods at issue was entitled to priority over the federal liens. Petitioner contended that a lien for

state taxes arises on the date of the assessment of the tax (under Minn. Stat. § 270.69(1) (West 1992)) and that state taxes are deemed automatically assessed under state law on the later of the date the return is filed or the date the return is due (under Minn. Stat. § 270.65 (West 1992)). Petitioner claimed that its liens therefore arose on June 2, 1992, the date the returns were filed, and were entitled to priority over the federal liens which arose on August 3 and August 10, 1992. Petitioner relied on *Cannon Valley Woodwork, Inc.* v. *Malton Construction Co.*, 866 F. Supp. 1248 (D. Minn. 1994), in which the district court held on similar facts that Minnesota tax liens held priority over the tax liens of the United States (Pet. App. 4).

The United States argued that petitioner's lien could not have been perfected against the federal liens until petitioner administratively processed the taxpayer's returns on August 20, 1992. Because the federal liens arose *before* that date, the United States contended that the federal liens held priority as first in time. The United States noted that in *In re Priest*, 712 F.2d 1326 (1983), modified, 725 F.2d 477 (1984), the Ninth Circuit held that the "mere receipt" of a tax return under a California statutory scheme similar to Minn. Stat. §§ 270.65 and 270.69(1) (West 1992) was insufficient "to establish a lien that is capable of taking priority over a federal lien." 712 F.2d at 1329.

The district court granted summary judgment to petitioner (Pet. App. 16-21). The court concluded that the state tax lien was perfected upon the mere filing of the taxpayer's returns and was therefore entitled to priority as first in time (*id.* at 19-20).

3. The court of appeals reversed (Pet. App. 1-15). The court held that the state tax liens were not perfected on the date the tax returns were filed because

the Minnesota Commissioner of Revenue is required by state law to take administrative steps to establish the amount of the taxpayer's liability *after* the return is filed (*id.* at 10-11). The court concluded that petitioner's lien was not perfected against the federal liens because petitioner is required to "take some administrative action to acknowledge formally a liability before the amount of the lien can be deemed 'established' and the lien perfected" (*id.* at 11).

**ARGUMENT**

The decision of the court of appeals is correct and does not conflict with any decision of this Court or any other court of appeals. Further review is therefore not warranted.

1. Federal law governs the relative priority of the federal tax lien against claims asserted under state law by other creditors of a delinquent taxpayer. *Aquilino* v. *United States*, 363 U.S. 509, 513-514 (1960). Absent any federal statute to the contrary, the priority of the federal tax lien in competition with a state-created lien is governed by the common-law rule that "the first in time is the first in right." *United States* v. *McDermott*, 507 U.S. 447, 449 (1993). A federal standard governs the determination whether a competing state lien is "first in time" for this purpose: a state-created lien is perfected against the federal lien only when there is "nothing more to be done to have a choate lien—when the identity of the lienor, the property subject to the lien, and the amount of the lien are established." *United States* v. *City of New Britain*, 347 U.S. 81, 84 (1954). The state lien must be "certain as to amount, identity of the lienor, [and] the property subject thereto" to be perfected against the federal lien. *Id.* at 86. A state tax lien satisfies this federal standard

of perfection only when the "assessment is given the force of a judgment, and if the amount assessed is not paid when due, administrative officials may seize the debtor's property to satisfy the debt." *United States* v. *Vermont*, 377 U.S. 351, 359 (1964) (quoting *Bull* v. *United States*, 295 U.S. 247, 260 (1935)).

The lien claimed by petitioner in this case did not satisfy these federal standards and was not perfected against the federal liens on the date the federal liens arose. The court of appeals therefore correctly concluded (Pet. App. 15) that the federal liens were entitled to priority as "first in time" in this case.

a. Under Minnesota law, taxes shown as due on a return, together with interest and penalties, become a lien upon all of the taxpayer's property within the State "from and after the date of assessment of the tax." Minn. Stat. § 270.69(1) (West 1992). Under state law, "the term 'date of assessment' means the date a return was filed or the date a return should have been filed, whichever is later." § 270.65. For purposes of state law, petitioner's tax lien thus arose on the date that the taxpayer filed its returns (June 2, 1992)—a date that was two months before the federal taxes were assessed and the federal tax liens arose under 26 U.S.C. 6321.

It is well established, however, that state law does not control the priority of the federal lien and that the "characterization of a lien by the State is not, of course, conclusive against the Federal Government." *City of New Britain*, 347 U.S. at 84. See also *United States* v. *Security Trust & Savings Bank of San Diego*, 340 U.S. 47, 49-50 (1950); *Michigan* v. *United States*, 317 U.S. 338, 339-340 (1943). "Local statutory provisions that fix a lien date prior to [the time the lien becomes perfected under the federal standard] must be ignored for the purpose of resolving the federal-state priority ques-

tion." William T. Plumb, Jr., *Federal Tax Liens* 180 (3d ed. 1972)). "Otherwise, a State could affect the standing of federal liens, contrary to the established doctrine, simply by causing an inchoate lien to attach at some arbitrary time even before the amount of the tax, assessment, etc., is determined." *City of New Britain*, 347 U.S. at 86. A Minnesota tax lien is thus not perfected against the federal lien on the date a taxpayer files a return simply because Minnesota regards that as the "date of assessment" for purposes of state law. The court must still determine whether the state lien satisfies the federal standards of perfection on that date. Pet. App. 9.

The court of appeals correctly held that petitioner's lien did not satisfy the established federal standards. The state lien was not perfected under the federal standards on the date that the return was filed because, on that date, (i) the amount of the lien had not been determined (*City of New Britain*, 347 U.S. at 86) and (ii) the lien was not summarily enforceable in the absence of an administrative determination of that amount (*Vermont*, 377 U.S. at 359).

Minnesota law requires the state tax commissioner to "make determinations, corrections, and assessments with respect to state taxes, including interest, additions to taxes, and assessable penalties." Minn. Stat. § 289A.35 (West 1992). After a return is filed, the state commissioner is required by state law to examine the return and make a determination of the taxpayer's liability. *Ibid.* As the court of appeals correctly held, it is "[b]eyond doubt" that "it is this determination that formally establishes the amount of the taxpayer's liability" under state law (Pet. App. 10).

Minnesota law also specifies that, when such a tax "is not paid within the time specified for payment, a

penalty must be added to the amount required to be shown as tax." Minn. Stat. § 289A.60 (West 1992). When, as in this case, withholding taxes are not timely paid, state law thus requires the state commissioner to add a penalty to the liability. This penalty, along with any interest due on the unpaid liability, is not computed until the tax return is administratively processed. *Cannon Valley Woodwork, Inc.* v. *Malton Constr. Co.*, 866 F. Supp. 1248, 1252 (D. Minn. 1994). As a result, it cannot be said, at the time the taxpayer filed its returns, that there was "nothing more to be done" (*City of New Britain*, 347 U.S. at 84) to determine the amount of the lien and to perfect petitioner's lien under the established federal standard. On the date that the federal liens arose (August 3 and August 10, 1992), the state returns still had to be examined, the state tax liability still had to be determined by the state commissioner, and the delinquency penalty and interest had to be computed and added to the amount of the state tax. The federal liens had priority because, on the dates that they arose, the amount of the state lien was neither "certain" nor "established" by an administrative determination of liability. *City of New Britain*, 347 U.S. at 84, 86.

Contrary to petitioner's claim (Pet. 6-9), the state lien was not summarily enforceable on the dates the federal liens arose. Under Minnesota law, "notice and demand for payment of the amount due" must be sent to a taxpayer before the State may summarily levy upon a taxpayer's property. Minn. Stat. § 270.70(2)(a) (West 1992). As the court of appeals explained (Pet. App. 11), notice and demand for payment "of the amount due" could not be sent until the state commissioner examined the taxpayer's returns, determined the taxpayer's liabilities, calculated the required penalty for non-

payment and interest and added these amounts to the unpaid tax. These were not merely "ministerial acts"; they were instead "substantial contingencies" that had to be resolved through an administrative determination of the amount of the taxpayer's liability "before the state tax liens could be enforced" and before any "levy c[ould] be made" under state law (*ibid.*).*

Petitioner errs in asserting that this interpretation of Minnesota law "mandate[s] the examination and correction of literally millions of tax returns" (Pet. 12). Minnesota law parallels federal law in requiring an official determination of tax liabilities; but neither state nor federal law requires a formal audit for this purpose. Under the state tax practice (like the federal practice), the determination of liability is made by an administrative processing of the return. The state tax commissioner made precisely such an administrative determination of the taxpayer's liability in this case—a determination that was completed on August 20, 1992, shortly *after* the federal tax lien arose upon the assessment of the unpaid federal taxes (Pet. App. 3).

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* Petitioner errs in asserting that its tax liens were "even more readily 'summarily enforceable' than the tax lien that this Court validated in *Vermont*" (Pet. 7). The State's lien in *Vermont* arose "at the time the assessment and demand [were] made by the commissioner of taxes" (*United States* v. *Vermont*, 317 F.2d 446, 447 (2d Cir. 1963), aff'd, 377 U.S. 351 (1964)), and "Vermont * * * could have enforced its lien * * * either by a civil action in the courts or by direct seizure and public sale" (*id.* at 448). Under Minnesota law, petitioner could *not* lawfully have seized the taxpayer's property on the day the taxpayer filed its tax returns (Pet. App. 11), for no administrative determination leading to a notice and demand for payment of the amount due had been made (*ibid.*). The state lien was thus not summarily enforceable prior to the dates on which the federal liens arose.

> By processing the [tax returns], Minnesota took administrative action that established that the taxpayer was liable to the State of Minnesota for unpaid taxes, including the amount of the unpaid taxes and the amount of any penalty and interest.

*Cannon Valley Woodwork, Inc.* v. *Malton Constr. Co.*, 866 F. Supp. at 1252. As the court of appeals held, it is only upon the completion of that state administrative process that the federal requirement that the amount of the lien be "established" and "certain" is fulfilled (Pet. App. 10-11).

b. Petitioner contends that the court of appeals "ignores * * * reality" (Pet. 8) in requiring the lien amount to be certain, because interest on a tax liability continues to accrue. Petitioner further argues that its liens were, in any event, perfected to the extent of the principal amount of tax due because, upon filing its returns, the taxpayer "made a disclosure and declaration as to the tax it owed" and the amount of that liability was not thereafter changed by the commissioner (*ibid.*).

These contentions are unavailing. The decision of the court of appeals does not negate the principle that a tax return constitutes a declaration by the taxpayer of its asserted liability. Federal law nonetheless requires that "the amount of the lien [be] established" before the state lien can be perfected against the federal tax lien. *City of New Britain*, 347 U.S. at 86. Under Minnesota law, the amount of the lien cannot be determined, and the lien cannot be enforced, until the return is administratively processed and notice of the amount due is issued to the taxpayer (Pet. App. 10-11). Once the lien is thus perfected, interest accrues on that amount by operation of law, and the sort of constant amendment of

the lien postulated by petitioner is not required. See, *e.g.*, *In re Bay State York Co.*, 204 B.R. 277, 282 (Bankr. D. Mass. 1996); *Middlesex Sav. Bank* v. *Johnson*, 777 F. Supp. 1024, 1026 n.3 (D. Mass. 1991).

Contrary to petitioner's claim, the decision below does not render the provision of state law that defines "the 'assessment' as the date of filing * * * utterly superfluous" (Pet. 13). With respect to competing claims under state law, the state statute would presumably govern. The priority of the federal lien, however, is not governed by state law, and the "characterization of a lien by the State is not, of course, conclusive against the Federal Government." *City of New Britain*, 347 U.S. at 84.

2. There is no conflict among the courts of appeals that have interpreted and applied provisions of state law similar to those involved in this case. In the present case, the court of appeals (Pet. App. 11-12) expressly agreed with the conclusion of the Ninth Circuit, applying similar provisions of California law, that a state lien "cannot arise prior to the taking of any administrative steps to establish the lien" and that "[t]he mere receipt of a delinquent State tax return * * * is too vague and indefinite [a standard by which to establish a lien that is capable of taking priority over a federal lien]." *In re Priest*, 712 F.2d at 1329, citing *City of New Britain*, 347 U.S. at 86. Decisions involving similar state laws in other circuits have reached this same conclusion. See, *e.g.*, *Baybank Middlesex* v. *Electronic Fabricators, Inc.*, 751 F. Supp. 304, 310 (D. Mass. 1990) ("in order for the amount of the [State's] lien to be established, there must be 'some activity by the State to fix the taxpayer's liability'") (quoting *In re Priest*, 712 F.2d at 1328); *Brown* v. *Maryland*, 699 F. Supp. 1149 (D. Md. 1987) (the filing of returns is insufficient to

create a perfected lien under the federal standard even though, for purposes of state law, the state lien arose upon the due date for such returns), aff'd, 862 F.2d 869 (4th Cir. 1988) (Table). Review by this Court is therefore not warranted in this case.

## CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

SETH P. WAXMAN
*Solicitor General*
LORETTA C. ARGRETT
*Assistant Attorney General*
BRUCE R. ELLISEN
RANDOLPH L. HUTTER
*Attorneys*

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